SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1947

No. 377

WILLIAM ALBERT BELCHER,
Petitioner and Appellant Below,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent and Appellee Below

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

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To the Honorable, the Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

Your petitioner respectfully shows:

Summary Statement of the Matter Involved

This is an action brought in The Tax Court of the United States by your petitioner (hereinafter called "taxpayer") against the respondent in respect to a determined deficiency

in income tax for the year 1941. The Tax Court held the taxpayer owed the tax (R. 52). The Circuit Court of Appeals for the Fifth Circuit, on Petition for Review (R. 127), affirmed that judgment.

The taxpayer is a member of a partnership engaged in the lumber manufacturing business. The firm buys standing timber, fells it, and transports the logs from the forest to the millsite near Birmingham, Alabama, where the lumber is manufactured, processed and sold.

The taxpayer entered the lumber business in 1926 (R. 98). He had a modest beginning (testimony of Mrs. Belcher R. 67 and taxpayer R. 92). About 1935 he began to operate as a sole proprietor under the name of W. A. Belcher. The enterprise enjoyed a gradual but substantial growth. By 1940 there were two hundred and fifty persons employed (R. 91). While the income of the taxpayer had, during this period, increased proportionately with the growth of his business, his liabilities had commensurately spiralled upwardly and in 1940 he was heavily involved. Among his large obligations was the purchase price of over 100 million feet of standing timber on over 34 thousand acres for which he had agreed to pay and to cut and remove within a specified period (R. 100).

It was in the early part of the year 1940 that the feasibility of changing from a sole proprietorship to a partnership with his wife, individually, and his wife as trustee for his children was first canvassed. The plan under consideration envisioned giving his wife, and his wife as trustee for his children, certain portions of his estate which would be contributed to the partnership as a percentage of its capital assets. As so conceived, the plan was put into effect in December of that year.

It is significant to point out how these matters first came to be broached and the true and compelling reasons actuat-

ing the change. The record demonstrates these reasons palpably and without contradiction.

A Mr. Foster, trust officer of a Birmingham bank, was approached by the taxpayer. Mr. Foster reviewed the taxpayer's financial affairs and suggested the change from the sole proprietorship to the partnership. Mr. Foster testified:

> "As to the reason he gave for forming the partnership, my answer is, that to be frank, I think I put the idea in his head. I told him he was speculating too much on those timber lands. He didn't buy land, as I understand it, he just bought the timber off the land. He had to get the timber off in a certain length of time." (Testimony of Foster, R. 113.)

The taxpayer himself testified that he had several purposes in making the gift to his wife and creating the trusts for his children and thereafter entering into the partnership. Primarily, he said, was the matter of their protection. The tax angles, both income and gift and estate, as he frankly stated, were weighed up by him along with the other factors to which he gave consideration (testimony of taxpayer R. 91).

The testimony of the taxpayer's wife confirmed this in all respects:

> "Mr. Belcher advised me at the time he made these gifts what the purposes for them were. He told me that he wanted to set up a trust estate for our security, mine and that of the children, in case anything happened to him, for our future security and benefit." Testimony of Mrs. Belcher, R. 68.)

And one Dendy, who, during this period was the assistant manager of the taxpayer in his lumber operations, but who at the time of the trial in the court below was no longer associated with him in any capacity, testified to like effect:

> "Mr. Belcher discussed with me the reason for forming the partnership. He had, to a certain degree, been

> successful in his business. The lumber business was of a very hazardous nature. He wanted to make provision for his family and assure their security. For that reason he wanted to take them in as partners in his business." (Testimony of Dendy, R. 88.)[1]

These things were testified to without dispute, viz., that the real and moving cause for the making of the gift to his wife and the establishment of the trusts for his children was not to reduce his taxes, but on the contrary came about because of his currently precarious financial position against which he was eager to assure, insofar as he was able, the financial security of the members of his family. That the taxpayer knew that such a course would reduce his taxes is undoubtedly true (R. 91) for as the witness Dendy, on cross-examination, declared:

> "It would have been foolish if he did not think of that." (R. 89.)

Accordingly, and actuated by these considerations, the taxpayer put the plan into effect in the following manner. On December 23, 1940, he executed a deed of gift to his wife wherein he transferred and conveyed to her an undivided thirty-four per cent (34%) interest in the following property:

> "All mills, machinery, equipment, tools, trucks, tractors, and all rolling stock now owned by me, or equity which I have therein, which were heretofore used in the manufacture, processing and transportation of lumber or timber by me, doing business under the

[1] It should be borne in mind that throughout this period wherein the income of the taxpayer showed a steady and substantial growth, his increasing debts were personal to him alone. In the gift to his wife. and in the creation of the trusts for his children and in the formation of the partnership, he pursued a formula whereby he avoided saddling off these large personal obligations upon the objects of his beneficence.

> trade name of W. A. Belcher Lumber Company, (but this gift or interest created thereunder does not apply to or include the real estate on which said mills, machinery or equipment is now located or any timber, finished or unfinished, or any timber standing or cut, which is now owned by me)." (R. 15.)

This deed of gift from the taxpayer to his wife was introduced and appears as Exhibit 1 and is also identified as Exhibit B to the petition filed in The Tax Court (R. 15).

Coincidently with this gift, the taxpayer established four trusts for each of his children, at that time named and aged respectively: Mary, aged 14; William, aged 6; Van Elam, aged 3; Katherine, aged 10 days. His wife was named as trustee in each of these trusts to each of which was conveyed an undivided eight per cent (8%) interest in the property above set out and described.

The trusts were irrevocable. (R. 23.)

The trusts were to continue until the particular beneficiary became 21 years of age (R. 24), when it would terminate and the trust estate be turned over, free and clear, to the *cesti que trust*.[2]

Each of these four deeds of trust, except for the differing names of the children, was the same. They were introduced in evidence and appear as Exhibits 2, 3 and 5, and one of them was attached as Exhibit C to the petition in The Tax Court (R. 15).

It is significant that in each of the trust indentures there was a further repetition of the real and compelling motive actuating the creation of the trusts by the taxpayer. Para-

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[2] Mary Earnestine Belcher, eldest of the four children of the taxpayer attained her majority of 21 years on May 12, 1947, and she is, therefore, now entitled, in accordance with the terms of the trust, to have her portion turned over to her, untrammeled by the restrictions of trusteeship. (Testimony of Mrs. Belcher, R. 65.) Mary Earnestine is a child of the taxpayer by a former marriage and step-daughter to Mrs. Belcher, her trustee.)

graph 1 in each of the trust agreements reiterates the undisputed testimony of the several witnesses that it was the settlor's concern, rendered acute by his own large financial obligations, for the financial security of his children.

In each of the trusts the taxpayer forbade the use of income to discharge his own financial and parental obligations to his children (Par. 12, R. 21). These obligations, he said, he planned to continue to discharge as he had in the past. He did do so. (Testimony of Belcher, R. 95 and 107).

> "Mr. Belcher paid all household expenses out of his drawing account and in 1941 he paid all of the expenses of both myself and the children. I never asked to withdraw any money." (Testimony of Mrs. Belcher, R. 79.)

The taxpayer's deed of gift to his wife and the four deeds of trust for his children were all filed for record in the Office of the Judge of Probate of Jefferson County, Alabama, on December 27, 1940, four days after they were executed (R. 16; R. 25).

Eight days after the execution of these instruments and four days after their recordation in the place of records and on December 31, 1940, articles of partnership were executed by the taxpayer, by the wife of the taxpayer and by the wife of the taxpayer as trustee for the four children (see Exhibit 6, R. 67, also appended as Exhibit D to petition, R. 25).

For capital, each of the three partners contributed his interest in the property described in the deed of gift and in the deeds of trust. The taxpayer contributed an undivided thirty-four per cent (34%) interest therein; the wife an undivided thirty-four per cent (34%) interest therein; and the trustee four undivided interests of eight per cent (8%) each therein (R. 26).

The usual and customary provisions were found in the agreement of partnership. The taxpayer was made manager of the business and paid a salary of $400.00 per month and given the usual broad power and authority of this office (R. 29). His wife, in her individual capacity, was made secretary with her compensation fixed at $250.00 per month (R. 32). Naturally, the partnership agreement required the performance of no services, vital or otherwise, by Mrs. Belcher as trustee of the four children or by the children themselves.

The partnership agreement provided that all of the expenses of the business, including those incurred for equipment and machinery replacements should be paid out of the income or capital without any further authorization from the partners. It directed the setting up of a reserve fund for future contingencies including the purchases of lumber, timber, machinery, equipment and real estate and for the expense of the firm's business. All partnership profits were to be kept in the partnership assets except such part as should, from time to time, be distributed by agreement of the partners. All of the net profits could be withdrawn at any time if the partners unanimously agreed to do so, and any partner could, at his election, leave his share of the profits in the firm as a loan and receive interest thereon.

The profits and losses were to be divided proportionately with the capital contributed by each of the partners; thirty-four per cent (34%) to the taxpayer; thirty-four per cent (34%) to the wife, individually, eight per cent (8%) to the trustee of Mary, eight per cent (8%) to the trustee of William, eight per cent (8%) to the trustee of Van Elam, and eight per cent (8%) to the trustee of Katherine (R. 28).

The effective date of the partnership was January 1, 1941, or one day after it was signed. The partnership was to continue for a period of seven years unless it was pre-

viously determined as was provided in the agreement (R. 25). Each partner could retire at any time on thirty days' notice. (See Paragraph 6 of Amendment to Partnership Agreement, duly introduced in evidence and set forth as Appendix A to this brief.)

The establishment of the partnership—the transformation of the business from a sole proprietorship of the taxpayer was duly publicized. The First National Bank of Birmingham, depository of the taxpayer, was formally notified and given new signature cards (R. 93). Dun & Bradstreet, the financial agency, was duly informed (R. 94).

Instructions were given by the taxpayer to make the appropriate changes in the books of the concern. Mr. Dendy testified:

> "He (meaning the taxpayer) told me after the contract was signed, on or about the first day of January, 1941, when the partnership took effect and that the books should be started as a partnership as of that day. I carried out these instructions." (Testimony of Dendy, R. 81.)

And when the Accountant Whitaker audited the books of this concern a year or so later, while finding inaccuracies (which he corrected) in the elementary bookkeeping methods pursued (which he extended and clarified) he had no difficulty in determining that these records did in fact constitute the records of a partnership:

> "I certainly concluded from the books that there was a partnership." (Cross-examination of Whitaker, R. 120.)

Reports by the taxpayer of the gifts to his wife and children were seasonably made (March, 1941) and the gift tax paid to the tax authorities (R. 110).

As set up in these reports, the aggregate value of the property of which the wife had been given an undivided

thirty-four per cent (34%) interest and the four children an eight per cent (8%) interest, each, with the taxpayer retaining an undivided thirty-four per cent (34%) interest, was $80,000.00.[3]

On March 18, 1941, the partnership agreement between the taxpayer, his wife and his wife as trustee for the four children, was modified by a further instrument in writing (R. 110).

The true reason underlying the execution of the amended articles of partnership was, as fairly found by The Tax Court, that "the business was in need of operating capital," and the petitioner so informed his wife and called upon her to contribute it, both individually and in her capacity as trustee (R. 46). The amended partnership agreement expressed the urgent need for more money in the business. It pointed out that the taxpayer had contributed the good will and had agreed to sell the partnership certain timber and lumber without profit, and that neither of these factors had been taken into account in reckoning the respective percentages of the profits. It was agreed, therefore, that the wife should contribute $20,000.00—$10,000.00 individually and $10,000.00 as trustee.[4]

Accordingly Mrs. Belcher borrowed $20,000.00 from one S. E. Belcher, brother of the taxpayer. $10,000.00 of this sum was borrowed individually and $10,000.00 as trustee for the four children. She had this power under the trusts.

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[3] There has been a governmental determination that this valuation and the gift taxes paid upon it were inadequate. That determination is presently the subject of a suit in The Tax Court (R. 38).

[4] Because of the large significance which we attach to this instrument—it was to all intents and purposes laid out of the case by The Tax Court below—we have included a copy of it in the appendix to this brief. It was duly recorded in the Office of the Judge of Probate of Jefferson County, Alabama. on March 19, 1941. It was introduced in evidence in the court below and appears as Exhibit 28 of the petitioner.

She gave her notes accordingly. They were her own notes, in no way guaranteed or endorsed by the taxpayer. They were her sole obligation (R. 71 and Exhibits 23 and 24).

Mrs. Belcher paid over the proceeds of the two loans to the firm, all in accordance with the terms of the modified agreement of partnership. The firm books reflect the receipt of this money from her. Her individual investment account was credited with $10,000.00 and her investment account as trustee credited with a like sum.

These loans to S. E. Belcher were repaid by Mrs. Belcher (after periodic payments of interest by her) some 17 months later (R. 71). The checks which were given in payment of these two loans were checks of the partnership. Mrs. Belcher's accounts, individually and as trustee, were duly debited for the payment of the two loans. That these payments were made by partnership checks is immaterial as they were duly charged to Mrs. Belcher, individually and as trustee.

With the consent and knowledge of his wife, the taxpayer withdrew approximately $200,000.00 from the partnership during 1941 for the payment of the purchase price of timber in his own name (R. 69). The taxpayer testified that these purchases of timber were for the benefit of the partnership and that he did not transfer them to the partnership because, as they stood, he alone was obligated for the purchase price, and in this manner his family's interest in the partnership assets was protected and conserved (R. 104).

The record shows that after the formation of this partnership in 1941, it was sued for an alleged violation of the National Labor Relations Act. The suit was commenced by the appropriate agency of the Government in the District Court of the United States for the Northern District of Alabama, and the defendants, as designated by the Gov-

ernment, were the taxpayer, his wife, and his wife as trustee for the four children, as the constituent partners of the defendant firm (R. 93).

The nature and extent of the labors and services contributed by Mrs. Belcher to the operation of the business of the firm is the subject of considerable testimony. Mrs. Belcher testified about it. She said that, when she came to work for the taxpayer in 1928, she was still in high school: that she did odd jobs, helping with the books, the invoices and at the taxpayer's commissary and otherwise assisted her mother, who, at that time, was employed by the taxpayer as his head bookkeeper. She graduated from high school in 1930 and the nature and scope of her activities in the employ of the taxpayer increased. She married him in 1932. Between that time and the formation of the partnership, she had three children, the last being born on December 13, 1940, or 17 days prior to the formation of the partnership. No doubt from the time of her marriage and through the formation of the partnership and thereafter during the year 1941—the period involved in this suit—the sum total of her contribution of labor and services was materially diminished by reason of the births of her three children and the time necessarily given to their care and upbringing.[5]

> "I spent as much time as possible at the office and helped every way that I possibly could." (Testimony of Mrs. Belcher, R. 73.)

Mrs. Belcher testified that she discussed matters of policy with her husband (R. 68).

The taxpayer testified that he did not take any substantial steps such as the operation of his plant or the pur-

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[5] This is recognized by The Tax Court who apparently uses it as an argument to support its description of Mrs. Belcher's contributions to the operation of the business as being minor and inconsequential.

chase of large tracts of timber or any other matters involving an expenditure of extraordinary amounts of money without consulting with Mrs. Belcher:

> "It was my habit to consult with Mrs. Belcher on any deal of any size. We would always discuss it. The whole thing was a mutual proposition" (R. 100).

In March of 1942, the taxpayer filed and paid income tax on the basis of thirty-four percent (34%) of the net profits of the partnership for 1941. Mrs. Belcher, wife of the taxpayer, filed a return and paid an income tax on a similar percentage. With respect to the four trusts, she filed returns as trustee in each instance and paid a tax in behalf of each on the basis of eight percent (8%) of the net profits of the partnership for the year 1941.

The respondent rejected this apportionment of the partnership income. He contends that the entire net income of the partnership for the year 1941 should be taken into the income account of the taxpayer and not divided thirty-four percent (34%) to Mrs. Belcher, individually, and eight percent (8%) to her as trustee in each of the four trusts. A deficiency was assessed accordingly. The validity of this assessment is the only question involved in this case.

The Tax Court decided in favor of the Commissioner and against the petitioner. That decision was affirmed by the Court below.

The foregoing facts are not in dispute and it may be said that they were fairly and correctly stated in the "Findings of Fact," of The Tax Court (R. 40-52). It is with that Court's application of the law that we take exception.

Jurisdictional Statement

It is contended that the Supreme Court has jurisdiction to review the judgment here in question because:

(a) It is a decision in conflict with the decisions of other Circuit Courts of Appeal on the same matter. *Armstrong*

v. *Commissioner,* 143 F. (2d) 700 (C. C. A. 10); *Hall* v. *Commissioner,* 150 F. (2d) 304 (C. C. A. 10); *United States* v. *Morss,* 159 F. (2d) 142 (C. C. A. 1).

(b) It has decided an important question of Federal Law which has not yet been, but should be settled by this Court.

The statutory authority under which such jurisdiction is invoked is 28 U. S. C. Section 347 (Judicial Code, Section 240, as amended).

The date of the judgment to be reviewed is July 2, 1947.

Questions Presented

Was the taxpayer taxable on the entire 1941 net income of W. A. Belcher Lumber Company, a partnership composed of the taxpayer and of his wife, and of his wife as trustee for their four children, or was he taxable only on the income of the business payable to him alone, or was he taxable on such income payable under the partnership agreement to him and his wife individually but not taxable on the income from the business payable to his wife as trustee for their children.

Reasons Relied On for Allowance of Writ

The Court below has rendered a decision, which insofar as it lays a tax on the income properly allocable to the trustee for the four children is in conflict with the decisions of Courts of Appeal of other Circuits (*Armstrong* v. *Commissioner,* 143 F. (2d) 700 C. C. A. 10; *Hall* v. *Commissioner,* 150 F. (2d) 304 C. C. A. 10; *United States* v. *Morss,* 159 F. (2d) 142 C. C. A. 1).

As to this aspect of the decision of the Court below, that is, that part of the judgment which taxes the taxpayer on the income allocable to the trustee for the four children (as distinguished from the income allocable to the wife individually) the Court below has decided an important ques-

tion of Federal law, which insofar as your petitioner is informed, has not yet been settled by this Court, but because of its importance should be so determined.

Wherefore your petitioner prays that a writ of certiorari issue under the seal of this Court to the Circuit Court of Appeals for the Fifth Circuit, commanding said Court to certify and send to this Court a full and complete transcript of the record and of the proceedings of the said Circuit Court had in the case numbered and entitled on its docket No. 11931, *William A. Belcher,* Petitioner, v. *Commissioner of Internal Revenue,* respondent, to the end that this case may be reviewed and determined by this Court as provided for by the statutes of the United States; and that the judgment herein of said Circuit Court be reversed by this Court and for such further relief as to this Court may seem proper.

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Petitioner,

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1947

No. 377

WILLIAM ALBERT BELCHER,
Petitioner and Appellant Below,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent and Appellee Below

BRIEF IN SUPPORT OF THE PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

Opinions of the Court Below

The opinion of the Circuit Court of Appeals (R. 127) is reported in — F. (2d) —; that of The Tax Court (R. 52) in 8 T. C. 182.

Jurisdiction

This has already been set forth in the preceding petition and is here adopted and made a part of this brief.

Statement of the Case

Under "Summary Statement of the Matter Involved" *supra,* a sufficient statement is made, fully to understand this case and it is here adopted by reference.

Specification of Errors

The Court below erred in holding that the income of the partnership, allocable to the trustee for the use and benefit of the children, was taxable to the taxpayer.

The Court below further erred in holding that the partnership income, allocable to the wife individually, was taxable to the taxpayer.

THE ARGUMENT

Summary of the Argument

A. The Court below erroneously held that the partnership between the taxpayer and his wife, as trustee for the children, had no significance for income tax purposes.

B. The Court below erroneously held that the partnership between the taxpayer and his wife individually had no significance for income tax purposes, particularly as

(1) The gift to the wife was valid and complete.

(2) There was a substantial contribution of capital by the wife originating with her.

(3) The wife, within the range of her capacities, did share in the management and operation of the partnership business.

(4) The gifts of capital by the husband were not intended to relieve and did not relieve the donor of his familial obligations and duties.

(5) The income of the partnership here involved was not produced by the labors of the husband, as substantial capital was embarked upon the enterprise with which was allied a large organization.

(6) The family's financial security was the compelling motive in the establishment of the partnership; and while the by-product of tax reduction was anticipated it was purely incidental.

Argument

Point A. On May 16, 1947, a fortnight before this case was argued and submitted in the Court below, that Court put out *Scherf* v. *Commissioner,* 161 F. (2d) 495, and *Benson* v. *Commissioner,* 161 F. (2d) 821.

Dealing as these two cases did with trusts established by a parent for the use and benefit of his children—the settlor then becoming a partner in the business with the trustee—we were thoroughly aware that in the Court below (unless the *Scherf* and *Benson* cases were modified or retracted) our position in the instant case was well nigh hopeless. For although there were grace notes to be found in the Benson and Scherf renditions not here present, their main theme was identical with that of the case at bar. We knew that if the Court below had concluded to extend *Lusthaus* v. *Commissioner,* 327 U. S. 293, and *Commissioner* v. *Tower,* 327 U. S. 280 (which as understood dealt with an entirely different situation) to the *Scherf* and *Benson* cases, there would be no hesitancy in here doing likewise. So results fell out. The *Scherf* and *Benson* cases were reaffirmed by the judgment rendered in this case. The Court below cited and stated that application was being given to the *Lusthaus* and *Tower* doctrine.[6]

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[6] This should be clearly noted. The Court below, in deciding this case as well as *Scherf* and *Benson,* did not rely on *Helvering* v. *Clifford,* 309 U. S. 331, where the parent established a five-year trust with reversion to him. *Lusthaus* and *Tower* were the lodestar of the decision below being here and in the *Scherf* and *Benson* cases applied to irrevocable trusts where no possibility of reversion to the settlor existed.

That *Scherf* and *Benson*, as well as the instant case, were decided by one and the same Court adjudicating *Kell* v. *Commissioner* 88 F. (2d) 453, and *Montgomery* v. *Thomas*, 146 F. (2d) 76, and *Allen* v. *Beazley*, 157 F. (2d) 970, and *Thomas* v. *Feldman*, 158 F. (2d) 488, does not render them or this case less difficult of understanding.

In *Kell* v. *Commissioner, supra*, the owner of an interest in a lease account—a partnership—notified his partners that he was giving his interest in the enterprise to his wife and children and ordered the income from that interest to be paid to them. The tax authorities claimed that Kell owed the tax on that income because he continued to handle the money and because he had agreed with his partners that he would still be responsible to them as though a partner and for other reasons. The Tax Court agreed. This conclusion was overturned by the Court below who through Judge Hutcheson, author of the *Scherf* and *Benson* cases, declared:

> "We think the evidence, taken as a whole, admits of only one conclusion that Kell *divested himself not of the profits but of the interest from which the profits were derived.*"

And compare *Allen* v. *Beazley, supra*, where subsequent to *Tower* and *Lusthaus*, the Court below, after speaking of the suspicion necessarily attached to "family arrangements," approved one for tax purposes.[7]

And in an even later case *(Thomas* v. *Feldman, supra)* where the *Lusthaus* and *Tower* cases were mentioned, but viewed as not controlling, the Court below affirmed a judgment of a District Court on stipulated facts, not materially

[7] *Allen* v. *Beazley* was cited by the Court below in its opinion in the instant case—why, we are at a loss to comprehend save perhaps that the two opinions had a common author.

here distinguishable, upholding, for tax purposes, the validity of a family partnership between the settlor (parent) and a trustee for the former's children.

Be that as it may, however, it is the high privilege of the Court below to change its judicial mind though it is somewhat disconcerting when done without reference to earlier, inconsistent pronouncements save to cite one of them *(Allen v. Benson, supra)* as supportive of the new dispensation.

But it is somewhat more than merely disconcerting when the Court says that its new doctrines are demanded by precedents of this Court, which we submit, do nothing of the kind as other Circuit Courts of Appeal have plainly announced.

United States v. *Morss*, 159 F. (2) 142, was decided by the First Circuit subsequent to *Lusthaus* and *Tower*. It mentioned neither of these cases although both of them, then almost a year old, had achieved a tolerable notoriety in legal circles. We must assume, therefore, that the First Circuit did not regard them as controlling precedents any more than they should be so viewed in the case at bar.

Morss, the taxpayer, naming himself as trustee, created four trusts for each of his four children, the oldest of whom was then seven years old. The trusts' assets consisted of shares of stock in a corporation of which Morss was president and treasurer and in which he had a very substantial interest.

The trusts which Morss established were irrevocable just as here. After distinguishing the *Clifford* case, and after eloquently omitting all reference to *Lusthaus* and *Tower*, the First Circuit held the income from the trusts not taxable to Morss:

> "In setting up the trusts, the grantor gave away the beneficial interest in the income-producing property. Having in mind 'the normal concepts of full ownership,' we do not see how it could be said here that what

the grantor gave away was 'insignificant' and that he remained in substance the owner of the corpus. The basis for attributing the trust income to the grantor under Sec. 22(a) is therefore absent. To test this proposition, let us suppose that the taxpayer's father had established these trusts, designating the taxpayer as trustee, and that all the other terms of the trusts were as in the case at bar. We think the taxpayer would then be recognized as merely the holder of the legal title in trust, and that no one would suggest that for tax purposes he should be regarded as the 'full owner.' The only difference between the supposed case and the case now before us is that in the case at bar the income is being dealt with year by year in accordance with the taxpayer's own determination back in 1936. But that does not constitute the taxable realization of economic gain; for if it did, it would result even in taxing 'to a father the income of a simple trust with a disinterested trustee for the benefit of his adult child'—which of course is not done."

(*Helvering* v. *Stuart*, 1942, 317 U. S. 154, 168, 63 S. Ct. 140, 147, 87 L. Ed. 154.)

It is true that the *Morss* case was an appeal from a District Court whereas here the case originated in The Tax Court. There are other differences between the two cases but the underlying principle which there controlled and here should control is precisely the same. The First Circuit is in conflict with the Court below.

Recent pronouncements of the Tenth Circuit may be found enlightening. In *Armstrong* v. *Commissioner*, 143 F. (2) 700, the Tenth Circuit reversed the decision of The Tax Court holding the father liable for income on a portion of partnership assets in trust for his children.

The father, the chief partner in the business, was himself the trustee. The Court said:

"The tax court found and concluded that petitioner's absolute control of management of the trust estate, the short trust period, the family business and relationship,

coupled with the fact that the son used some trust funds to defray his expenses at an eastern law school, when all considered together, constituted petitioner in reality the true owner of the trust estate.

"(7) The tax court concluded that the case fell within the decision of the Supreme Court in *Helvering* v. *Clifford*, 309 U. S. 331, 60 S. Ct. 554, 84 L. Ed. 788. In that case the Supreme Court stressed the close family relationship; the fact that no substantial economic change occurred under the Clifford trust, that while some legal rights were surrendered, when the indirect benefits flowing from the trust through the wife were considered, the trustor had a fair equivalent of what he had before. The court quite rightfully pointed out that these family relationships will be carefully scrutinized and that when it appears that substantially but one economic unit exists, then no devices, no matter how skillfuly devised, attempting to set up separate units, will be recognized, even though they are valid under state law.

"This is as it should be. But this does not mean that a father may not in good faith make a gift of property to his son under a trust in which he is the trustee and is vested with powers of control and management. Where such powers exist, a critical, analytical search will be made of the trust instrument to surely ascertain that no economic benefit was intended or may inure to the benefit of the trustor, and that such powers of management are for the sole benefit of the trust and not directly or indirectly for the benefit of the creator of the trust. In *Jones* v. *Norris*, 10 Cir., 122 F 2nd 6, 11, we said:

" 'We do not understand that the power of management, however unlimited, may operate to bring the grantor within the sweeping provisions of Section 22(a) (26 U. S. C. A. Int. Rev. Acts, page 669), if by such powers he cannot derive any economic benefit therefrom, * * * the grantor retained neither the power to revoke, revest or revert either the corpus or the income.'

"See also *Hogle* v. *Commissioner*, 10 Cir. 132 F 2nd 66."

The principle of the Armstrong case was affirmed in *Hall* v. *Commissioner*, 150 (2) 304, where the same Court declared:

> "(7) It was the intention of the trustor to grant to himself as trustee the same power to deal with the trust property as he possessed before the establishment of the trust, and it may be argued that this unusual grant of power enabled the trustee to invest the trust funds for his personal advantage and benefit, thereby vitiating the trust entity and realizing the economic gain necessary to produce a taxable income under Section 22(a). It may be conceded that the power to invest trust funds for the trustee's personal advantage and benefit is equivalent to the taxable enjoyment of the trust income, but we cannot say that the absolute power of the trustee to deal with the trust property as if it were his own empowers him to use it for his own personal advantage and gain. Such a construction of the trust instrument would be contrary to the fundamental principles of equity which guide trustees and protect trust property."

And compare the even later case of *Sinopoulo* v. *Jones*, 154 F (2) 648.

* * * * * * *

In its opinion in this case The Tax Court declared:

> "In view of our decision as to the claimed partnership, it is unnecessary to consider whether, as a separate proposition the taxpayer would or would not be taxable on any income of the trusts as such." (R. 54.)

The Court below likewise lumps together the gift to the wife and the income therefrom on the one hand and the gifts to the trustee for the use and benefit of their children and

the income therefrom on the other, making no distinction whatever between the two highly diverse situations.

It is respectfully submitted that the solution, as respects the income from the trusts, is not quite so casually to be found nor is it meet that these trusts, so entirely different in character from the gift to the wife, should be treated so cavalierly.

The record shows that these four trusts were established by the taxpayer with every possible legal formality.

The record shows why he created them. His reasons were not venal. They were praiseworthy.

The record shows that these trusts were not established secretly but in an atmosphere of public notoriety of which the respondent had actual notice upon which he shortly acted.

The record shows that the trustee (not the taxpayer) had plenary powers in the administration of the trust including the power to exchange property belonging to the trust estate, to lease it, to retain or sell it, and to devote the assets of the trusts to enterprises other than the parnership here under scrutiny.

The trustee was given the power to withdraw from any business in which she was engaged (a right preserved under the partnership agreement later entered into).

The record shows that the trusts were not here created by the settlor to avoid his parental obligations of support and maintenance owed to his children. These obligations were in fact independently discharged by him.

And finally the record shows that these trusts were irrevocable.

The vice provoking the *Tower* and *Lusthaus* decisions—the alleged partnerships between husband and wife so susceptible of "bed-chamber rearrangement"—is not, in these trusts, even remotely inherent. For this taxpayer effec-

tively and irretrievably divorced himself of the *Power* of *Control* of the property given to the trustee for the benefit of his children. Not even with their approval and consent —not even if they actually willed that it be done—could these four children, after the execution and recordation of the deeds of trust, restore the *status quo ante* and reinvest their father with ownership and power of control of their respective portions. Only a Court of equity could do this and then under all the safeguards there provided and after the payment by the taxpayer of the fair value of these properties.

To stigmatize these trusts as "sham" so as to bring them within the strictures of *Lusthaus* and *Tower* is to blind oneself to the realities of the situation. There was no "sham" about them. They were real in every sense. They were irrevocable. From them, the taxpayer could not "rue back." And when these children, through their trustee, embarked their portions in the partnership enterprise, they thereby contributed substantially to its operations albeit in a relationship with the taxpayer requiring of him the utmost *punctilio*.

A favorite juristic cliche in the decision of these cases—Judge Hutcheson used it in the *Scherf* case—is that "one must not divorce the fruits from the tree." That is not this situation at all.

When property or an interest in property produces the income (and was so intended to do as where an irrevocable trust is set up for an infant) the property or property interest is the tree. The effect of the decision of the Court below is that the tree itself (or an interest therein) cannot be transferred to members of a taxpayer's family.

*   *   *   *   *   *   *

It was with considerable consternation that we read in the opinion of The Tax Court (tacitly, at least, approved by the Court below) that Mrs. Belcher, *as trustee* for these children, rendered no services that were "vital" to the business and that as a consequence, the partnership between the taxpayer and the trustee must be adjudged a "sham" and the income from the trust taxable to the taxpayer and not to the children.

It is quite true that Mrs. Belcher, *as trustee*, rendered no services to the operation of the partnership. It is difficult to imagine what kind of services she could have rendered in that capacity, if, indeed, any were expected. More logically as it seems to us, The Tax Court and the Court below should have invalidated these trusts because no vital services were rendered by the children as they were the real, the beneficial owners of the property, not their mother, the trustee.

The trust indentures ordained (in certain contingencies) that a certain trust company should succeed Mrs. Belcher as trustee for each of these four children (R. 23). Is it to be assumed from the argument of The Tax Court and the Court below that, did the trust company become the trustee, it would be required, in that capacity, to render "vital services" to the partnership if it were not to be invalidated? It is somewhat alarming to dwell upon the thought that it has been judicially determined that the failure of the *trustee* to do what she could not and was not expected to do, would be seized upon as a shibboleth for invalidation and as an insigne of chicane.

* * * * * * *

So far as counsel for the taxpayer are informed, this Court has never passed upon the precise question here presented; that is, as to trusts for children as distinguished from gifts to spouses. It would appear that the question—one of Federal law—is of sufficiently large import to war-

rant its settlement by this Court. The writ should be granted for that additional reason.

Point B. We realize, of course, that as to the income of the partnership payable to the wife individually (as contradistinguished from that payable to her as trustee) our case is not so clear. *Tower* and *Lusthaus*. But these cases did not undertake to speak with respect to an irrevocable trust established by a parent for the benefit of his own children.

It is nevertheless respectfully submitted that there are certain fundamental differences between the gift to this wife individually and *Tower* and *Lusthaus*, rendering them here inapplicable. And in speaking of these differences, we refer to fundamental and important circumstances rather than to the inconsequential variations which necessarily exist between any two cases.

(1) In the first place, we desire to invite attention to the fact that the gift made by this taxpayer to his wife was valid and complete in all respects. It was so affirmed by The Tax Court. It was not gainsaid by the Court below. In the *Tower* case, the situation was different. There, Mr. Justice Black, after several times referring to the gift in the *Tower* case as "alleged" and as "purported" says of it:

> "The Tax Court concluded that the respondent had never executed a complete gift of the assets his wife later purportedly contributed to the partnership." (*Tower* Case p. 283)

The validity of the gift to this wife is further strengthened by the current pendency of a suit in The Tax Court in respect to an alleged deficiency in the gift tax declared and paid by the taxpayer when he made the gift.

(2) In the second place, we contend that this case is different because here the wife made a contribution of capital which did, in fact, originate with her, individually and as

trustee. The record shows that about three months after this partnership began, all the partners agreed that additional funds were needed. The reasons why they should be contributed by the wife and the trustee (rather than the taxpayer) are set out in the Amendment to the Partnership Agreement (appearing in Appendix A hereto).

The wife (individually and as trustee) undertook to get this money from an outside source. True, that source was a brother of the taxpayer. But the money was lent to the wife individually and to the trustee upon their signatures alone. It was their liability alone. It was not the liability of the taxpayer.

The proceeds of these two loans were duly and properly entered upon the books of the partnership, the wife and the trustee each being credited, in their respective investment accounts, with $10,000.00 These notes were repaid seventeen months later.

The respondent, echoed by The Tax Court, makes a great to-do because the profits of the business were used to make these payments and they were made by partnership checks. What difference does this make? They were properly charged to the wife individually and to the trustee.

The notes were not repaid under any sort of agreement. They were unconditional promises to pay, in no sense guaranteed by the taxpayer, and their discharge from the profits of the business was only a hope that later materialized.

(3) In the third place, we say this case is different because the facts show, as indeed are found by The Tax Court (though it draws a specious conclusion therefrom), that the wife, within the range of her capacities, did in fact share in the management and operation of the partnership business.

When the wife came to work for the taxpayer in 1928, she was a high school girl. She helped her mother, the taxpayer's head bookkeeper, doing various odd jobs, assisting with the books, making invoices, and working in the taxpayer's commissary. When she graduated from high school in 1930, her activities were enlarged. She said she spent as much time as was available in the office and helped in every way possible (R. 73). She married the taxpayer in 1932. Matters of policy came to be discussed.

These facts are without dispute and The Tax Court so found.

Within the range of her capabilities it is nowhere made to appear in the record in this case that the wife did not do all she could in assisting in the management and operation of the partnership business. True, as The Tax Court found, she did not understand the complexities of double entry bookkeeping (R. 50). Neither, we suspect, could she fell a tree.

During these years, as the record shows, the wife of the taxpayer took time out to have three children, the youngest, Katherine, being seventeen days old when the partnership was formed. Naturally, during the travail of bearing these children and nurturing them, Mrs. Belcher could not and did not devote as much time to the business as she otherwise would have been able to do. These circumstances were mentioned by The Tax Court in their legal conclusion that the services of Mrs. Belcher was "minor" and "inconsequential." But we submit that any such commentary has no more legal significance than the extraordinary judicial pronouncement solemnly enunciated by The Tax Court that Mrs. Belcher could not have rendered vital services because she did not know how to keep double entry books.[8]

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[8] Curiously enough, the Court below in one of its recent decisions (*Singletary* v. *Commissioner*, 155 F. (2d) 207), recognized that in a family partnership between husband and wife, the wife was excused from working

(4 and 6) Again we assert that this case is different from *Lusthaus* and *Tower* in that the gifts here were never intended to relieve and did not relieve the taxpayer of his familial obligations. We have already pointed out above and at considerable length what the evidence showed were the reasons for the gifts. These reasons were rational reasons. They were commendable reasons. There was a tax benefit to be enjoyed, to be sure, and the taxpayer was not idiot enough to fail to recognize it but all of the evidence in this case shows that this was not the motivating reason for the gift. It was different in the *Tower* case. Mr. Justice Black there declared:

> "* * * her purported share of the partnership business she actually expended was used to buy what a husband usually buys for his wife such as clothes and things for the family, or to carry on activities ordinarily of interest to the family as a group." (*Tower* case, p. 286).
>
> "And the wife drew on income which the partnership books attributed to her only for purposes of buying and paying for the type of things she had bought for herself, home and family before the partnership was formed." (*Tower* case, p. 291.)

(5) And finally, we say that this case is different because the labors of the taxpayer did not produce the income on which the taxgatherers are now seeking to tax him. The labors of the taxpayer helped, as we readily admit. But W. A. Belcher Lumber Company, in 1941, was a large organization. It represented important money. Its income was earned by the employment of this capital and the toil

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while she was having and caring for a baby. Judge Waller. who wrote that case, got quite poetical. He said: "The undisputed facts in this case clearly show that the taxpayer and his wife were carrying on business in partnership during the tax years in question even if one of the partners, after having acquired partnership rights *'had to stay at home and rock a cradle.'*" (Italics supplied.)

of many men—sawyers, cutters, truck drivers, boatmen—two hundred fifty of them. According to the condition of the market and with the capital engaged, they made the profit. To contend that the taxpayer must be taxed on the income of this partnership because his labors produced it, is to indulge in the sheerest rhetorical hyperbole.

The Conclusion

This case has a dual aspect. The one involves a partnership between a father and the trustee of his children. The other presents a partnership between husband and wife. The two are not necessarily to be measured by the same yardstick.

It is conceivable that the end result of the tax incidence of the two relationships might not be the same. But we submit that for the reasons suggested *Tower* and *Lusthaus* do not apply to the husband and wife and *a fortiori,* not to father and trustee.

It is, therefore, respectfully submitted that this case is one calling for the exercise by this Court of its supervisory powers, by granting a writ of certiorari and thereafter reviewing and reversing said decision.

Respectfully submitted,

Al. G. Rives and

J. Kirkman Jackson,

Attorneys for Petitioner,

818 Massey Building,

Birmingham, Alabama.

APPENDIX "A"

State of Alabama,
Jefferson County.

Amendment to Partnership Agreement

This indenture made the 18th day of March, 1941, between William Albert Belcher, party of the first part, Nell Vandergrift Belcher, party of the second part, and Nell Vandergrift Belcher as trustee respectively for each of the following: Mary Earnestine Belcher, William Albert Belcher, Jr., Van Elam Belcher, and Katherine Ann Belcher, party of the third part. All of Birmingham, Jefferson County, Alabama:

Witnesseth, that whereas, on the 31 day of December, 1940, the parties to this intrument executed a partnership agreement, and have been operating under said partnership agreement to the date this instrument is signed; and, whereas; the partnership formed between parties to this instrument, on said above mentioned date, has incurred, in the course of operation of the partnership business, certain obligations and debts which are due and should be paid; and, whereas, it has been ascertained by the partners that the partnership firm lacks sufficient capital to properly conduct the partnership business, and that additional capital is necessary for said purpose; and, whereas; party of the first part put into the partnership the good will which he had established for the firm name adopted by the partnership and agreed with the other partners, who are parties to this instrument, to sell to the partnership firm lumber and timber which party of the first part owned at the time of the execution of said above mentioned partnership agreement; at a cost or near cost price; and, whereas; it is agreed by all the parties to this instrument that, in consideration of said facts mentioned above, said additional capital should be supplied by party of the second part and party of the third part, to equalize their contribution to the partnership assets on a basis with that contributed by party of the first part.

Now Therefore, for and in consideration of the premises set out above, it is hereby mutually agreed, by and between the parties to this instrument, that said partnership agreement executed by and between the same parties as to this instrument, on the 31 day of December, 1940, shall be, and the same is, hereby amended as follows:

1. Party of the second part agrees to contribute $10,000.00 in cash, in addition to the assets already contributed by her, to the partnership assets, which shall become and constitute additional capital of the partnership.

2. Party of the third part agrees to contribute $10,000.00 in cash, in addition to the assets already contributed by her, to the partnership assets, which shall become and constitute additional capital of the partnership.

3. Said additional capital, so contributed by party of the second part and party of the third part, shall be used by the partnership firm for partnership business the same as any other capital heretofore contributed by any of the partners, and all partners shall own an interest in and to said additional capital in the same ratio which their respective interests bore to each other under the original partnership agreement, that is to say, to-wit, party of the first part 34%, party of the second part 34%, and party of the third part a total of 32%.

4. Section 3 is hereby amended to read as follows: "The retirement of any partner shall not dissolve the parnership as to the other partners."

5. Party of the first part is to continue to act as general manager as provided in Section 13 of the original partnership agreement dated December 31, 1940, but Section 14 on Page 4 of said partnership agreement is hereby amended to read as follows:

> "Each and every party to his contract shall have all of the powers set out in the following paragraphs numbering from (a) to, and including, paragraph (j)."

(The purpose of this amendment is to give each of the partners concurrent and equal power and authority to do

any and all of the things set out in said enumerated paragraphs without being required to first obtain any further consent of the other partners). Any provision contained in said enumerated paragraphs, which originally limited the authority of party of the first part so as to require the consent of the other partners shall still apply, and shall now relate to all of the respective partners the same as originally related to the party of the first part only.

6. Section 21, beginning on Page 8 of the original partnership agreement, is hereby amended to read as follows:

> "Any partner may retire from the partnership, at any time, by giving thirty days previous notice in writing to the other partners or partner, and at the expiration of such thirty days period of time the partnership shall terminate accordingly as to the partner giving such notice, and he shall be entitled to receive his or her share of the accumulation of the profits of the partnership in the ratio which his or her interest in the partnership bears to the other partners. The remaining partner or partners shall have the option to purchase such retiring partner's interest in the partnership firm at a price to be agreed upon between them. If no price can be agreed upon for the purchase of the retiring partner's interest, the matter shall be submitted to a board of arbitrators composed of three members, one being selected by the retiring partner and one being selected by the remaining partner or partners and the third being selected by the two members so selected, who shall fix a fair valuation on the entire partnership assets, including good will, and the remaining partner or partners shall have the option to purchase such retiring partner's interest at the sum which his percentage of interest in the firm bears to the total valuation fixed by such board of arbitration."

7. Section 22 and 23 on Page 9 of said original partnership agreement is hereby stricken out, in their entirety, the same as if they had never been inserted in said partnership agreement, and henceforth shall have no force or effect.

All other parts and provisions of the original partnership agreement executed on the 31 day of December, 1940, which is not hereby expressly amended, is hereby readopted, and shall remain the same as originally written.

The amendments set out above shall become effective immediately upon the execution of this instrument.

In Witness Whereof, the parties hereto do hereby affix their signature and seal on this the 18th day of March, 1941, at Birmingham, Alabama in triplicate.

[S.] William Albert Belcher,
Nell Vandergrift Belcher,
Nell Vandergrift Belcher,
Trustee respectively for each of the following: Mary Earnestine Belcher, William Albert Belcher, Jr., Van Elam Belcher, and Katherine Ann Belcher.

Witnesses: (S.) C. M. Dendy, E. A. Oliver.

Filed in office for record this the Mar. 19, 1941 and duly recorded in Vol. 3159 page 566. Eugene H. Hawkins, Judge of Probate.

INDEX

CITATIONS

765662—47

In the Supreme Court of the United States

OCTOBER TERM, 1947

No. 377

WILLIAM A. BELCHER, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 39–54) is reported at 7 T. C. 182. The opinion of the Circuit Court of Appeals (R. 127–130) is reported at 162 F. 2d 974.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered July 2, 1947. (R. 131.) The petition for a writ of certiorari was filed October 1, 1947. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the court below erred in affirming the Tax Court's decision that business income attributed by taxpayer to his wife, individually and as trustee for their children, under a so-called partnership agreement, was includible in taxpayer's gross income as defined in Section 22 (a) of the Internal Revenue Code.

STATUTE AND REGULATIONS INVOLVED

These appear in the Appendix, *infra.*

STATEMENT

The pertinent facts found by the Tax Court (R. 40–54) may be summarized as follows:

From 1935 until the commencement of the taxable year (1941) taxpayer conducted a lumber manufacturing business as sole proprietor. On December 23, 1940, he executed a deed of gift transferring to his wife an undivided 34% interest in part of the physical assets of the business. On the same day he executed four identical deeds of trust transferring to his wife as trustee an 8% interest in the same assets for the benefit of each of his four children, who ranged in age from ten days to fourteen years. (R. 40–42.) On December 31, 1940, taxpayer entered into a "partnership agreement" with his wife, the latter acting both individually and as trustee for the children. The agreement provided that the business was to be operated under the same name as before; that

the partnership was to continue for seven years from January 1, 1941; that its capital consisted of the aggregate interest of the parties in a portion of the business assets theretofore owned by taxpayer; and that the interests of the parties were 34% each for taxpayer and his wife, and 32% for the wife as trustee. Taxpayer was to be general manager and receive a salary of $400 per month, while his wife was to be secretary and head bookkeeper and receive a salary of $250 per month. Partnership funds were to be deposited in a partnership bank account, and checks could be drawn only on the signature of taxpayer or, when authorized by him, of the bookkeeper. Expenses were to be paid only on taxpayer's authorization. Profits were to be retained in the business, except such part as should from time to time be distributed by agreement of the parties. (R. 42–44.) The deeds and partnership agreement were recorded, a gift tax return was filed and a gift tax of $145.20 paid, and formation of the partnership was reported to taxpayer's bank and to Dun & Bradstreet. (R. 46, 49.)

The wife and children owned no property other than that which they acquired from taxpayer and contributed as capital to the partnership. (R. 47.) When the deeds of gift and trust were delivered to the wife she understood that the donated assets were to be contributed to the partnership. (R. 45.) In March of 1941 the

business needed operating capital and the partnership agreement was modified to provide for an additional contribution of $10,000 by the wife individually, and of $10,000 by her as trustee. The $20,000 was borrowed from taxpayer's brother, through negotiations of taxpayer, on two unsecured promissory notes signed by the wife individually and as trustee. Taxpayer immediately borrowed this $20,000 from the partnership and used it to pay individual obligations. (R. 47–48.) Partnership funds were later used to repay the $20,000 borrowed from taxpayer's brother. (R. 49.) The wife contributed no capital originating with her, either individually or as trustee. (R. 53.)

After formation of the partnership the business was operated in the same manner as before. Taxpayer placed the business assets to which he had retained title (including timber, lumber, cash and accounts receivable) at the disposal of the partnership. The cash and proceeds of accounts receivable were used in part to defray operating expenses of the business and taxpayer's bills payable as of December 31, 1940, the balance being credited to his account. (R. 46–47.) At the beginning of 1941 taxpayer requested an assistant to set up accounts on the books to reflect the interests of the partners, but no such change was made. (R. 47.) Early in 1942 an accountant, when preparing taxpayer's income tax return for

1941, informed taxpayer that the books did not contain investment or drawing accounts for the wife and trusts. At taxpayer's direction he rewrote the ledger from original journal entries and set up investment accounts for taxpayer, the wife and the trusts. He also reconstructed taxpayer's individual account, which disclosed that at the close of 1941 taxpayer owed the business $196,037.87. (R. 48–49.)

The wife had no bank account during 1941, either individually or as trustee. She received no funds from the partnership during that year, either for herself or the children, and did not seek to do so. (R. 49.) Nor did she have any authority to draw on the partnership bank account. (R. 50.) She was credited on the books with a $250 per month salary. (R. 48.)

No vital services were contributed by the wife either individually or as trustee. She had entered taxpayer's employ in 1928 while a high school student on a part-time basis, and her principal duties consisted of making up payrolls and writing invoices. After her marriage to taxpayer (in 1932 (R. 40)) she performed the same kind of clerical work, devoting such time as she was able to spare from her household duties. After the partnership was formed she continued to perform the same services as before except that she "looked at the books more", but she did not supervise the books nor assume responsibility for

any entries. She has but slight knowledge of bookkeeping and does not know enough about the books kept by the partnership to explain any of the transactions reflected. Taxpayer discussed business problems with her occasionally, but managed the business as before and made all the decisions. The wife rendered no services of a managerial nature. (R. 49–50, 53–54.)

The net income of the business for 1941 as disclosed by the partnership return was $188,786.91, of which $64,187.55 was reported as the distributive share of taxpayer and the balance as the distributive share of the wife individually and as trustee. (R. 50–51.) The income taxes on the amounts allocated to the wife and the trusts were paid by the partnership on their behalf. (R. 49.) The Commissioner determined that the entire net income was taxable to taxpayer. (R. 51.) The Tax Court held that the alleged partnership was not real for federal income tax purposes, and sustained the Commissioner's determination. (R. 52–54.) The Circuit Court of Appeals affirmed. (R. 131.)

ARGUMENT

There is no occasion for further review. This case is controlled by *Commissioner* v. *Tower,* 327 U. S. 280, and *Lusthaus* v. *Commissioner,* 327 U. S. 293, with which the decision below is in accord.

1. The question here is the same as in the *Tower* and *Lusthaus* cases, *supra*. This Court there held that family partnerships erected upon gifts of business capital are without federal income tax significance, though valid under state law, if the arrangement produces no substantial change in the creation of the business income but merely a reallocation of it within the donor's family. And whether the claimed partnership, so tested, has reality presents a question of ultimate fact for the Tax Court, whose conclusion is entitled to finality if supported by substantial evidence. Unless the donee "invests capital originating with her or substantially contributes to the control and management of the business, or otherwise performs vital additional services, or does all of those things" (*Commissioner* v. *Tower, supra*, p. 290), the Tax Court is justified in concluding that the donee is not a real partner for tax purposes. These principles are not any the less applicable where, as here, the gift is to the wife as trustee for taxpayer's children, as well as to her individually, and the accompanying partnership agreement is executed by the wife in both capacities. Passage of titular ownership of a portion of the business capital to a fiduciary instead of directly to the donee affects the legal form, but not the economic substance, of the arrangement. *Hash* v. *Commissioner,* 152 F. 2d 722 (C. C. A. 4th), certiorari denied, 328 U. S. 879, rehearing

denied, 328 U. S. 838; *Dawson* v. *Commissioner* (C. C. A. 6th), decided September 22, 1947 (1947 C. C. H., par. 9368); *Eisenberg* v. *Commissioner,* 161 F. 2d 506 (C. C. A. 3d), certiorari denied, October 13, 1947; *Losh* v. *Commissioner,* 145 F. 2d 456 (C. C. A. 10th); *Benson* v. *Commissioner,* 161 F. 2d 821 (C. C. A. 5th).

As is plain from its opinion, the Tax Court properly addressed itself to the critical question of who earned the business income. It found that neither individually nor as trustee did the wife contribute capital originating with her, or participate in management, or perform vital additional services (R. 47–50, 53–54); in short, that after formation of the partnership the business was operated "in the same manner as it theretofore had been carried on" by taxpayer as sole proprietor (R. 46). The court below held that these findings were supported by substantial evidence (R. 128, 130), and they are not in dispute (Pet. 12). They amply warrant the conclusion that the wife was not a real partner, either individually or as trustee. Here, as in the *Tower* and *Lusthaus* cases, every ingredient productive of the business income in question—capital, services, and management—emanated from taxpayer.[1] While naked

[1] The wife performed some minor services (R. 49–50, 53), for which she was credited on the books with a salary of $250 per month (R. 48). Her salary was apparently deducted from gross profits in computing the partnership net income allocated among the partners. (R. 50–51.)

legal title to some of the business assets was shifted to the wife individually and as trustee for the children, and specified shares of the net business profits were ascribed to her as a partner, taxpayer continued as before to create the income. The wife became a "partner" in name and on paper only.[2] Under familiar rules governing the scope of judicial review of Tax Court decisions, reiterated by this Court in the *Tower* and *Lusthaus* cases with reference to the very question here presented, affirmance of the Tax Court's decision by the court below was clearly correct.

2. Isolating the gifts from the concurrent partnership agreement, taxpayer alleges conflict with decisions of Circuit Courts of Appeals in cases involving the taxability of trust income to the

[2] Not even the usual paper formalities were here fully observed, since investment and drawing accounts were not set up for the wife and trusts until after the taxable year. (R. 48.) Moreover, the income allocated to the wife and trusts was not distributed, but retained in the business; the wife maintained no bank account either individually or as trustee, received no partnership funds, and had no authority to draw any. (R. 49, 50.) Taxpayer thus continued to enjoy control over the income (as well as the corpus) of the partnership interests he purported to give away. The unreality of the arrangement is emphasized by the fact that although the wife and trusts purported originally to contribute 66% of assets valued at $80,000 (R. 43), and later an additional $20,000 (R. 47–48), or a total of about $73,000, the share of net profits ascribed to the wife individually and as trustee for the taxable year amounted to $124,599.36 (R. 51)—a return in a single year of over 170% of her so-called investment.

grantor of the trust. (Pet. 12–13.)[3] With the exception of *Armstrong* v. *Commissioner,* 143 F. 2d 700 (C. C. A. 10th), the cases relied upon are not concerned with family partnerships. Furthermore, the *Armstrong* case was distinguished by the court which decided it in *Losh* v. *Commissioner, supra,* whose factual pattern bears closer resemblance to that of this case; and any remnant of its vitality which may have survived the *Losh* case appears to have been extinguished by the still later decisions of the same court in *Grant* v. *Commissioner,* 150 F. 2d 915 (C. C. A. 10th), and *Bradshaw* v. *Commissioner,* 150 F. 2d 918 (C. C. A. 10th). See also *Earp* v. *Jones,* 131 F. 2d 292 (C. C. A. 10th), certiorari denied, 318 U. S. 764. In any event, whatever conflict in the field of "family partnership" cases existed among (or within) the circuits prior to *Tower* and *Lusthaus* has been authoritatively resolved by this Court's decisions in those cases.

3. Taxpayer's assertion (Pet. 13–14; Br. 25–26) that this case presents an important question which has not yet been settled, insofar as the wife's status as a trustee-partner is con-

[3] Even if the case be viewed in this distorted posture, there is no basis for taxpayer's assumption that the Tax Court was obliged to find that he ceased to be the substantial owner of the donated capital. *Helvering* v. *Clifford*, 309 U. S. 331.

cerned, misconceives the rationale of this Court's holdings in the *Tower* and *Lusthaus* cases.[4] The reality of a partnership arrangement predicated upon an intra-family gift obviously does not depend on whether the gift is outright or in trust, conditional or unconditional, or for that matter on what legal mechanics are employed. "By the simple expedient of drawing up papers, single tax earnings cannot be divided into two tax units and surtaxes cannot be thus avoided". *Commissioner* v. *Tower, supra,* p. 291. Unless the donee-partner contributes new capital, or performs vital additional services, or participates in management, there is no change in the creation of the business income and, accordingly, no change in the tax incidence. To permit the tax consequences here to turn upon the considerations stressed by taxpayer would sanction the very type of formalism which this Court in the *Tower* and *Lusthaus* cases refused to recognize as effectual to alter tax liability.

[4] Taxpayer's argument (Br. 17–30) is essentially the same as that advanced in support of the petition for certiorari in *Hash* v. *Commissioner*, *supra*, which involved gifts in trust and a partnership agreement with the trustees.

CONCLUSION

The decision below is correct. This case turns upon its facts and presents no question calling for further review. There is no conflict of decisions. The petition should therefore be denied.

Respectfully submitted.

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NOVEMBER, 1947.

APPENDIX

Internal Revenue Code:

SEC. 11. NORMAL TAX ON INDIVIDUALS.

There shall be levied, collected, and paid for each taxable year upon the net income of every individual a * * * tax * * *.

(26 U. S. C. 1940 ed., Sec. 11.)

SEC. 22. GROSS INCOME.

(a) *General definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * *, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

(26 U. S. C. 1940 ed., Sec. 22.)

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

(26 U. S. C. 1940 ed., Sec. 181.)

SEC. 182. TAX OF PARTNERS.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

*   *   *   *   *

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183 (b).

(26 U. S. C. 1940 ed., Sec. 182.)

SEC. 3797. DEFINITIONS.

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

*   *   *   *   *

(2) *Partnership and Partner.* — The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization.

*   *   *   *   *

(26 U. S. C. 1940 ed., Sec. 3797.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

SEC. 19.22 (a)-1. *What included in gross income.*—Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. (See sections 22 (b) and 116.) In general, income is the gain derived from capital, from labor, or from both combined, * * *.

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